Select Committee on Pension Policy

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October 3, 2005

2:00 pm - 4:00 pm
House Briefing Room

Plan 1 Unfunded Liability Subgroup

AGENDA

(1) Review of Options
- Option 2 - Resume Plan 1 UAAL payments
- Option 4 - Phase-in a step up of UAAL rates
- Option 5 - Establish rate floor with target funding ratio

(2) Role of the SCPP - Discussion

(3) Next Steps

SCPP and voting members: *Victor Moore (chair); Senator Craig Pridemore; Representative Barbara Bailey ; Glenn Olson.*

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Review of Options

Select Committee on Pension Policy
Plan 1 Unfunded Liability Subgroup

October 3, 2005

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State Actuary

Options From Executive Committee

- Option 2
  - Resume Plan 1 UAAL payments based on revenue forecast gains.
- Option 4
  - Phase in a step of UAAL rates.
- Option 5
  - Establish rate floor with target funded ratio.

Option 2

- Unanswered questions:
  - How much money is available?
  - Who pays?
  - How is the money collected?

How Much Money?

- Revenue forecast revision in September is an increase of $492.9 million.
  - Additional forecasts in November and February
- Are local and other revenue sources also improving?
  - Local government revenue is largely property-tax based (with caps on rate of increase); and
  - Non-general fund state revenue is more fixed fee based.

How Much Money?

- What is the priority for pensions as it relates to other budget priorities?
  - The ultimate decision rests with the legislature.
  - $173 million in GF-S ($488 million all sources) payments were required for 05-07 before suspension.
  - 03-05 payments were also skipped.

Who Pays?

- All employers
  - Assumes all employers have had revenue improvements.
  - Assumes local and state non GF-S will have adequate time to modify budgets.
  - All employers would pay their proportionate share.
- State only
  - Could lead to direct subsidy of future local government and state non GF-S payments.

How is the Money Collected?

- Reinstate employer contribution rate
  - All employers or state only.
  - Rates cannot be split by state GF-S and state non GF-S.
  - TRS rates cannot be split (local vs. state).
- Lump sum GF-S appropriation
  - Excludes local government and state non GF-S

Fiscal Analysis

- For the PERS 1 unfunded liability, each $100 million collected in the '07 fiscal year will save:
  - $117 million in interest through 2024 (all funds).
  - $3.7 million in the 07-09 biennium (GF-S only).
- For TRS 1, each $100 million collected saves:
  - $106 million in interest through 2024 (all funds).
  - $10.7 million in the 07-09 biennium (GF-S only).

Fiscal Analysis

- A 1 percent Plan 1 UAAL rate in PERS and TRS for FY ‘07 would generate:
  - $47.4 GF-S impact ($21.2 million in PERS); and
  - $60.3 million local government impact ($45.7 million in PERS)

Decision Variables

- Who pays?
- How is it collected?
- The timing is assumed to be the beginning of the next fiscal year

Decision Matrix for Option 2

Who?	How? Contribution Rate	How? GF-S Appropriation
All Employers	Avoids subsidy Assumes added revenue for all Assumes time for non GF-S budgeting	N/A
State Only	Impacts state non GF-S employers Ongoing split rates after FY '07 to avoid local gov't subsidy Administrative change	GF-S impact only Future subsidy for local and state non GFS Inefficient use of GF? No administrative change

Option 4

- Unanswered questions:
  - What is the appropriate length/cost of the phase in?
  - Should there be a "catch-up" within the phase-in period to avoid long-term impact?
  - With or without gain-sharing?

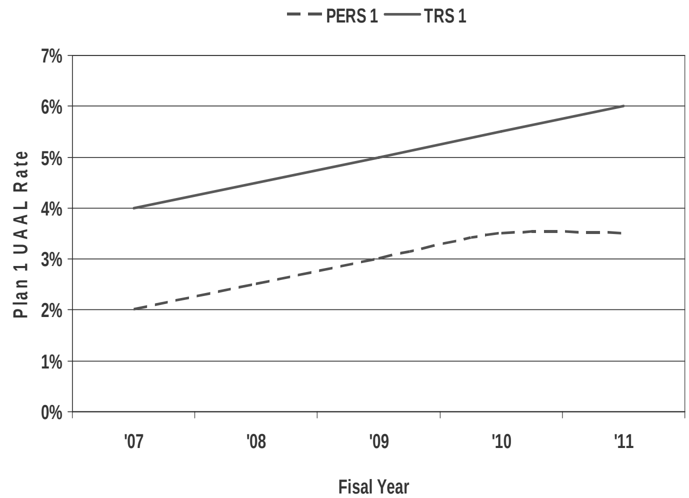
Where are Rates Headed?

- Projection of an ultimate PERS 1 UAAL rate of 3.35 percent starting in 2011-13
- 5.89 percent in TRS 1 starting in 2011-13
  - Note: Ultimate rates exclude the cost of future gain-sharing benefits.

Length of Phase-In?

- Length will depend on the payment amount in FY '07 (option 2).
- How quickly can PERS employers step into an additional rate of around 3.5 percent?
- How quickly can TRS employers step into an additional rate of around 6 percent?
  - Note: These rates are not the total rates
    - Excludes the Plan 2/3 normal cost rate

Phase-In Example
(without future gain-sharing)



With or Without Gain-Sharing?

- If gain-sharing continues, UAAL rates will be higher.
- If gain-sharing is traded off for other benefits of lesser value, UAAL rates will be reduced.
- If gain-sharing is repealed, UAAL rates will be even lower.

Cost of Phase-In?

- The cost will depend on several factors:
  - Length of phase-in;
  - Amount of payment in FY '07 (Option 2);
  - Whether the phase-in period includes a "catch-up" payment(s) to avoid long-term interest costs; and
  - Whether gain-sharing costs are included.
- The cost will be determined after these questions are answered.

Decision Variables

- Assumptions:
  - Gain sharing will be addressed by the legislature.
  - Subgroup will move forward without gain-sharing costs (better than no phase-in).
  - Coordinated with option 2.
- Length of phase-in?
- Include catch-up payments during phase-in?

Decision Matrix for Option 5

Phase-In Length	Catch-up Payment? Yes	Catch-up Payment? No
Shorter	Lowest long-term cost Highest short-term cost Avoids long-term interest cost Rate decrease after catch-up	Lower long-term cost Higher short-term cost Long-term interest cost Avoids rate decrease after catch-up
Longer	Higher long-term cost Lower short-term cost Avoids long-term interest cost Rate decrease after catch-up	Highest long-term cost Lowest short-term cost Long-term interest cost Avoids rate decrease after catch-up

Option 5

- Unanswered questions:
  - What is an appropriate long-term floor rate?
  - What is an appropriate target funded ratio?
  - With or without gain-sharing costs?
  - Effective date?

Example

- The Plan 1 UAAL rate shall not be less than x percent until:
  - The funded ratio exceeds the target; or
  - The amortization date, whichever comes first.

Judgment Call

- The selection of the floor rates and the target funded ratio require actuarial projections and judgment.

Recommendation

- Funding target of 125 percent.
- Floor rate for PERS 1:
  - 3.00 percent (with gain-sharing)
  - 2.75 percent (without gain-sharing)
- Floor rate for TRS 1:
  - 5.50 percent (with gain-sharing)
  - 4.75 percent (without gain-sharing)
- Effective date coordinated with phase-in.

Next Steps?

- Subgroup report to full SCPP in October.
- Subgroup to finalize recommendation(s) before November SCPP meeting.
- Final subgroup report to full SCPP in November.

SIX YEAR OUTLOOK

September 26, 2005

	2006	2007	2008	2009	2010	2011
Beginning Balance (General Fund-State)	824	868	894	564	213	(199)
Revenues						
BASELINE (September 2005 revenue forecast, 5% annual growth after 2007)	12,758	13,273	13,937	14,634	15,365	16,134
Money Transfers	130	87				
TOTAL REVENUE	**12,888**	**13,360**	**13,937**	**14,634**	**15,365**	**16,134**
Biennial Total		***26,248***		***28,570***		***31,499***
Expenditures						
Baseline Expenditures*	12,769	13,184	13,415	13,644	13,883	14,143
Pension Costs			205	259	357	389
K-12 Teacher/staff and Community and Technical Colleges COLA - Initiative 732 (2.7%, 2.2%, 2.0%, 2.0%)			99	207	304	404
*State employee/Higher Education COLA (1.9%, 2.1%, 2.2%, 2.4%)** Implicit Price Deflator*			45	96	150	211
Employee health insurance (state government, K-12, higher education) (10% per capita increase)			92	194	306	431
Medical Assistance (6% per capita increase; 3.5% caseload)			148	309	486	680
Continuation of Education Legacy Programs (Learning Assistance Program/Higher Education)			106	111	117	123
Subtotal	***12,769***	***13,184***	***14,109***	***14,820***	***15,603***	***16,380***
Estimated 2006 Supplemental Budget (potential caseload, other mandatory items)	75	150	158	165	174	182
TOTAL EXPENDITURES	**12,844**	**13,334**	**14,267**	**14,985**	**15,777**	**16,563**
Biennial Total		***26,177***		***29,252***		***32,339***
General Fund-State ENDING BALANCE	**868**	**894**	**564**	**213**	**(199)**	**(628)**
SUMMARY OF POTENTIAL BUDGET GAPS						
Potential General Fund-State Budget Surplus/Deficit (from projected ending balances)		**894**	**564**	**213**	**(199)**	**(628)**
Provision for General Fund-State Reserve			**(300)**	**(300)**	**(300)**	**(300)**
Potential Health Services Account Surplus/Deficit			**(63)**	**(211)**	**(421)**	**(700)**
Potential Legacy Account Surplus/Deficit		**(9)**	**(11)**	**(24)**	**(31)**	**(39)**
TOTAL POTENTIAL GAP		**885**	**190**	**(322)**	**(951)**	**(1,667)**

***BASELINE EXPENDITURE ASSUMPTIONS**

Assumes enacted 2005-07 budget.
Based on June Caseload Forecast Council (CFC) forecasts.
Assumes all other programs grow based on OFM population cohort forecast, and CFC forecasts where applicable.
Assumes vendor rate increase based on Implicit Price Deflator (IPD).

Assumes 3% inflation for non-Medical Assistance DSHS health care related programs (Developmental Disabilities, Long Term Care, Alcohol and Substance Abuse, Mental Health).
Assumes average debt service growth of 6.5% per year over forecast period.
Assumes "all other objects" (excluding salaries, benefits, pensions, vendors) grow by IPD plus one-half associated caseload or population growth.

Pension funding does assumption payment of unfunded liability, but does not include gain-sharing, which would cost $186 million in 2007-09, and $207 million in 2009-11.
** Does **NOT** include 2007 the one-time 1.6% salary increase in the base for future calculations per negotiated contracts and budget bill language.